

U.S. Department of Labor Finalizes Fiduciary Rule

On April 6, 2016, the U.S. Department of Labor (the "DOL") issued its long-awaited final regulation (the "Final Rules") re-defining what it means to be an "investment advice fiduciary" under the Employee Retirement Income Security Act of 1974 ("ERISA") and the Internal Revenue Code. The Final Rules significantly expand the class of advisers and the scope of investment advice that are subject to fiduciary standards and impose the same fiduciary standards on advisers to individual retirement accounts ("IRAs") that have long applied to plans covered by ERISA.

The DOL also finalized certain prohibited transaction exemptions which allow investment advisers to receive compensation for providing investment advice under arrangements which would otherwise be prohibited due to certain conflict of interest rules. Most notably, these exemptions include the so-called "Best Interest Contract Exemption" (or "BIC Exemption") which provides relief from the prohibited transaction rules where a fiduciary concludes that the investment advice is in the "best interest" of the plan or IRA (and satisfies certain additional requirements). Included below is a summary of the significant changes between the Final Rules and the final BIC Exemption and the proposed regulations and exemptions that were issued by the DOL last April (the "Proposed Rules").

Final Rules

As discussed in our [prior Client Memorandum](#), the Proposed Rules replaced the existing "five-part" test for determining the status of an "investment advice fiduciary" and imposed the same fiduciary standards that apply to ERISA plans to individual retirement accounts ("IRAs") and other non-ERISA plans. After considering substantial public comment, the DOL made a number of important changes to the Proposed Rules. These changes are described below:

- A person will generally be deemed an "investment advice fiduciary" with respect to a plan or an IRA if the person provides a "recommendation" as to certain investment decisions or the management of investment property. The Final Rules clarify

what it means to provide a "recommendation" for these purposes. Under the Final Rules, the analysis more closely mirrors FINRA guidance relating to investment recommendations, and focuses on whether the content, context and presentation of an adviser's communication should properly be viewed as a suggestion for the recipient to engage or refrain from taking an investment action. The more such advice is individually tailored to the recipient, the more likely it will be deemed a recommendation.

- Under the Proposed Rules, the definition of "investment advice" excluded any recommendation to an ERISA plan with 100 or more participants (subject to certain other requirements) or a fiduciary with at least \$100 million of assets under management by a counterparty in an arm's length transaction (referred to as the "seller's exemption"). Under the Final Rules, the "seller's exemption" generally covers plans and IRAs whose fiduciary is a bank, insurance company, registered investment adviser, broker-dealer or an independent fiduciary with at least \$50 million of assets under management (subject to certain additional requirements).
- Until further guidance is issued, appraisals, fairness opinions and similar statements will not be considered fiduciary investment advice under the Final Rules. The DOL provided that it will address issues related to these statements, including with respect to employee stock ownership plans ("ESOPs"), in separate rulemaking initiatives.
- The Final Rules provide additional clarity on what it means to provide a recommendation as to the "management" of investment property. Under the Final Rules, "management" is deemed to include recommendations with respect to investment policies, portfolio composition, as well as decisions regarding whether or not to take, and the form of, rollovers, distributions and transfers from plans and IRAs. The term "management" also covers recommendations on the selection of "other persons" to provide investment management services.
- The Final Rules also clarify the distinction between "investment advice" and "investment education" (which generally is not considered fiduciary in nature). The Final Rules specify that the provision of plan information, general financial, investment, and retirement information, asset allocation models, and interactive investment materials all fall within the investment education category. In a change from the Proposed Rules, the Final Rules allow, subject to the satisfaction of certain conditions and disclosure requirements, specific investment alternatives to be referenced in educational asset allocation models provided to participants without being deemed an investment recommendation. This safe harbor, however, only applies to plans subject to ERISA and does not apply in the IRA context.

Prohibited Transaction Exemptions

In addition to the Final Rules, the DOL also issued two new prohibited transaction exemptions: the Best Interest Contract Exemption and the Principal Transaction Exemption (as well as making certain technical amendments to other existing prohibited transaction exemptions).

Several important changes were made to the BIC Exemption, including:

- Under the prior DOL proposal, the BIC Exemption was only available to IRAs, participant-directed plans (such as "401(k) plans") and other plans with fewer than 100 participants. The final BIC Exemption replaces eligibility for plans with fewer than 100 participants with plans and IRAs with a "retail fiduciary" (i.e., plans that do not satisfy the seller's exemption described above under the summary of changes to the Final Rules).
- The proposed BIC Exemption provided a list of specific asset classes that were eligible to be covered under the exemption (thereby excluding investment advice recommendations with respect to other assets from coverage under the exemption). In an important change to the BIC Exemption, the exemption now covers investment advice with respect to all asset classes.
- The proposed BIC Exemption required a written contract between an adviser seeking coverage under the exemption and the applicable plan or IRA. The written contract requirement no longer applies to ERISA plans under the final BIC Exemption. Under the final BIC Exemption, the adviser, however, must acknowledge in writing its fiduciary status, comply with the "impartial conduct standards," and adopt certain policies and procedures to avoid conflicts of interest. In addition,

with respect to IRAs and other non-ERISA plans, the financial institution may amend existing contracts to comply with the exemption through negative consent procedures.

- The final BIC Exemption has streamlined several disclosure requirements involving asset recommendations, including eliminating disclosure of the expected costs to the plan or the IRA over a one, five and ten-year period, as well as certain annual disclosures regarding assets sold and acquired in the prior year. The final BIC Exemption also streamlines certain website disclosure obligations, limits the data retention requirements provided under the proposed BIC Exemption, and removes the requirement that financial institutions comply with all other federal and state laws relating to investment advice.
- After the publication of the Proposed Rules, many commentators raised concerns that financial institutions would not be able to rely on the BIC Exemption in connection with proprietary products offered by the financial institution (as well as concerns regarding what products would be considered proprietary). The final BIC Exemption clarifies that advisers may sell proprietary products so long as the investor is prominently informed that the financial institution offers proprietary products, all material conflicts are fully disclosed, the advice is consistent with "best interest" standards, only reasonable compensation is received by the adviser, and certain other conditions are satisfied.
- In response to public comments, the final BIC Exemption makes clear that advisers are not obligated to recommend the lowest fee investment option if other options are more appropriate to the advice recipient.

The Final Rules will take effect on April 10, 2017 (one year from the publication of the Final Rules in the Federal Register). Financial institutions will, however, be permitted to rely on the Best Interest Contract Exemption by complying with only a limited set of requirements through January 1, 2018.

We will distribute further details regarding the Final Rules and the related exemptions in an upcoming update. Please contact Robert A. Stone or Atul Jain of our Employee Benefits and Executive Compensation Group if you would like to discuss these matters further.

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